DOCKET FILE COPY ORIGINAL

ORIGINAL

RECEIVED

FEB 11 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
Rate Regulation	)	

REPLY COMMENTS OF COLE, RAYWID & BRAVERMAN

Jones Intercable, Inc.
Century Communications Corp.
TeleCable Corporation
KBLCOM Inc.
Columbia International, Inc.
Western Communications, Inc.
Greater Media, Inc.
Helicon Corp.
Monmouth Cablevision Assoc.
Allen's Television Cable Service, Inc.
Frederick Cablevision, Inc.
Gilmer Cable Television Company, Inc.
Grassroots Cable System
Halcyon Group, Inc.
OCB Cablevision, Inc.
Zylstra Communications Corporation
Cable Television Association of Maryland, Delaware and District of Columbia
New Jersey Cable Television Association
Texas Cable TV Association
West Virginia Cable Television Association

Paul Glist
James F. Ireland, III
Steven J. Horvitz
Theresa A. Zeterberg
COLE, RAYWID & BRAVERMAN
1919 Pennsylvania Ave., N.W.
Suite 200
Washington, D.C. 20006
(202) 659-9750

February 11, 1993

No. of Copies rec'd 0+4
List A B C D E

TABLE OF CONTENTS

RECEIVED

FEB 1 1 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	))))	MM Docket No. 92-266
Rate Regulation	)	

REPLY COMMENTS OF COLE, RAYWID & BRAVERMAN

INTRODUCTION

On behalf of the undersigned cable operators and associations, Cole, Raywid & Braverman hereby replies to the Comments filed in this proceeding.

SUMMARY

The soundest interpretation of the 1992 Act would test basic service rates against benchmarks derived from markets with effective competition. Basic should be regulated by cities with the legal authority and other qualifications to certify their jurisdiction to the FCC, or by less formal means within cities which choose not to certify. The satellite tier service rates of operators should be tested against the rates of the comparable systems of their peers so that the FCC could identify the "bad actor" outliers. Cost of service would be available only as a safety valve against confiscation. The Act only requires regulated equipment to be priced on the basis of cost. Equipment should be associated with the level of service for which the equipment is needed, and should be deregulated if the price is unbundled and compatible third party equipment is available.

In defiance of statutory directives, CFA abandons the effective competition standard for basic regulation in favor of a "global formulaic" approach intended to subject both basic and tier services to a pure cost analysis not intended by Congress. CFA's formula is premised on the mistaken belief that the cable industry can finance future technology and current programming on 1986 rates; and on the fantasy that declining premium revenues will sustain the industry after basic and tier rates are cut.

NATOA and its municipal allies accept benchmarks in name but render them irrelevant in practice. Prices could not rise within benchmarks without cost justification, and franchising authorities could drive prices down below benchmarks by demanding cost of service studies. Operators with above average costs would be left with only "normative" cost recovery. Cost of service regulation would import the complexity, inefficiencies, and distorted incentives which Congress directed the FCC to avoid. It would be still further distorted by the cities' efforts to assign overheads and common costs to everything but basic and tier services.

The cities further distort the Act by defining "effective competition" so as to exclude virtually all competition. This supplants the political ambitions of regulators for the marketplace force Congress preferred.

NAB offers a formula which would revalue the cable business as composed exclusively of current hardware, with no return for an operator's business or programming operations, but an assurance that broadcasters could impose retransmission consent fees without check.

CFA and the franchising authorities would draw no distinction between basic and tier regulation. Some would even subject tiers to the control of local franchising authorities, by "delegating" a non-delegable FCC duty, or by "defining" basic to include tiers. This construct would defy the Conference's deliberate removal of cities from control over satellite tiers, and subjecting satellite tiers only to bad actor complaint procedures at the Commission. It would also submit satellite tier programming, which has revolutionized the cable industry and the nation's programming diversity, to the parochial interests of cities.

The franchising authorities propose massive, reflexive rollback of rates and tiers not authorized by Congress and premised on undocumented suspicions about monopoly profits. The processes they propose are excuses for delays without regard to the impact on legitimate financial needs of an operator. They impose punitive measures of the type Congress specifically foreclosed. They would have the Commission invite franchising authorities to abrogate state, contract, and federal limitations on their legal authority. They would use "negative option" and "evasion" provisions to displace operators from their legitimate role in selecting programming, and even to discourage them from launching lifeline services. In all of this, franchising authorities would be immunized from liability and legally deferred to as "experts." Moreover, they would be insulated from political accountability by hiding the cost of franchise fees, PEG support, and other franchise costs from line itemization. This is a recipe for arbitrary confiscation.

I. GENERAL [¶4-5]

NATOA, NAB, CFA and their municipal allies base their case for universal rollback of basic and tier rates on common quicksand: the claim that Congress has found that all current rates contain monopoly profits which must be removed. NATOA claims (p.43), for example, "studies show that most cable rates contain monopoly rents." NATOA refers to Congress "finding" rate increases for the lowest level of service amounting to 40% for 28% of subscribers. The finding reveals nothing about profits or affordability: A $2.00 increase in a $5.00 basic rate amounts to 40%, but it may produce no return to the operator and offers a quite affordable rate. The City of Austin claims (p.7) that Congress determined that "rates would have to be reduced." The cited authority is to a far different statement: a requirement that satellite tier complaints be investigated, and the rates compared with reasonable business practices. Refunds are noted as a mere possibility. It is a quantum leap from Congressional targeting of "bad actors" to a universal rollback of all basic and tier rates for an entire industry.

The uncited studies and focus on prices does nothing to reveal the level of or justification for profits, because they do not adduce meaningful evidence of valuation, costs or comparable competitive rates. All have assumed that a businesses' legitimate value can only equal the book value of hard assets, and that any greater valuation reflects illicit monopoly profits. Cable's legitimate valuation derives as well from going concern, cash flow, and intangibles, the same as for businesses as competitive and diverse as real estate, entertainment, and grocers. Many of the proposals have also wrongly assumed that competition should eliminate even that cost of capital and a reasonable profit.

II. EFFECTIVE COMPETITION [¶8-10]

NATOA and its municipal allies suggest that "effective competition" be even more narrowly defined than it is in the Act. They suggest that a competitor cannot "count" as having "comparable" programming unless it has as many channels as cable. The statute says nothing of comparable numbers of channels. If competitors must have equivalent numbers of channels, then MMDS operators, who have fewer channels available for license (33) than cable operators have average channels in place (41), could never represent "effective competition." Yet wireless is competing very effectively and is being treated as a competitor for access-to-programming. Indeed, adopting such a test could create disincentives for lower capacity cable systems to upgrade channel capacity.

Austin insists that the competitor must offer the same "type" of programming. Not only is this not a statutory criteria but it would preclude clearly competitive HSD and DBS distributors from ever presenting "effective competition," because they do not carry local broadcast channels. NATOA tries a different means to define away HSD and DBS competition: by treating competition as not being "actually available" unless it advertises in local media, when the bulk of HSD advertising is in the national media like Satellite Orbit magazine.

The very penetration of a service is itself the best evidence of its actual availability. There is no need to supplement the statute with yet another test of consumer appeal. Anticipating that result, NATOA and its municipal allies seek to dilute measures of competitive penetration. NATOA insists that cable faces ineffective competition if 15% of subscribers find alternatives among more than one competitor. NATOA has ignored the statute's reference to plural "distributors," the legislative history's comparable reference, and the fact that competition in a market with three competitors would probably be more robust than in one with two. The City of Austin follows a similar tactic: it claims that competition available to 50% of the franchise area does not "count" unless there is perfect 50% overlap of homes passed. But if uniform rate structures are required within a franchise area, even a modest overlap should be sufficient to induce a competitive response.

NATOA plays the same game with MDUs. It requests that multiple subscribers in an MDU be counted as only <u>one</u> subscriber. This is one more attempt to define away competition, since SMATV and MMDS subscriber penetration is most likely to occur in MDUs. Bulk accounts should be counted at least on an equivalent basic unit basis, and more appropriately on a total unit basis, in order to equalize subscriber count when differently priced competitors compete for the same MDU market.

NATOA is obviously seeking to devise tests which will preserve local regulatory authority at all costs, regardless of the presence of effective market forces to which the statute gives priority.

III. BASIC SERVICE -- CONTENTS & REGULATIONS

A. Basic As A Mandatory Buy Through [¶11-12]

NAB advises that cable may not sell any service to customers without first selling the broadcast basic. This is a splendid example not just of doublethink but, by our count, of quadruplethink. NAB is simultaneously arguing that by removing satellite cable networks to create the broadcast basic service contemplated by Sec. 623(b)(7), operators are (1) creating "undesirable" basic service even when (2) the service is composed of the very broadcast signals which NAB elsewhere claims composes the principal value to consumers of cable. Further, NAB argues that (3) broadcasters must be protected from customers who would otherwise "buy around" the basic broadcast service in preference to cable services (4) even if that customer already receives broadcasting off-air, or from another source, or is seeking premium product as a supplement, or is ordering digital radio, interactive services, or other transactional services which do not even connect to the TV receiver. NAB is entitled at most to the literal protection given in the statute: mandatory buy through of basic to reach the satellite tier. Its efforts to artificially handicap cable must be rejected.

B. Only One Level of "Basic Service" Is Subject to Regulation Under Sec. 623(b) [¶13]

NATOA's search for regulatory lebensraum is nowhere more apparent than its bid for jurisdiction over satellite cable programming tiers. NATOA does so directly by asking the Commission to "delegate" its jurisdiction over tiers to local governments. The statute, of course, denies franchising authorities any role in tier disputes except that of complainant -- never as judge. Hence, NATOA and its allies seek the same result indirectly by asking the Commission to define satellite tiers as multiple levels of basic service. According to the ACLU case, this would occur if the cable operator has done the math for customers and added the price of the tier to the price of the basic service which is a "must buy" under the Act. According to NATOA and Austin, it would also occur if so ordered by the franchising authority or if the invoice billed for "cable service" instead of itemizing every tier. Another variation is NATOA's request that discounted packages -- which extend real value to consumers -- be treated as "tiers" if they contain premium services.

Such a formalistic approach is a vestige of the 1984 Act or pure municipal overreaching. It cannot be reconciled with the 1992 Act's new definition of basic, its jurisdictional split of authority, or its buy through rules. Section 623, and its legislative history make clear that local jurisdiction is confined to "the" basic tier established under 623(b)(7), not to multiple tiers. Congress very specifically rejected the Senate version which would have given NATOA the power it now seeks through regulation. It granted exclusive jurisdiction to the FCC, following a clear line of authority from the 1972 Cable Report through Nevada and the 1984 Act.

Multiple tiers of basic are not compatible with the right to buy around a tier. The Act provides a right to access premium services after buying "the" basic tier, not the ones Austin finds convenient to identify in its multiple basic hypothesis. Indeed, the very premise of tier buy through is to make satellite tiers optional and to segregate their costs from the reduced cost of a smaller basic service. Austin's effort to force 60 channels onto basic is fundamentally inconsistent with the Act's intended purpose to unbundle satellite services from basic.

Nothing would be more detrimental to the national programming marketplace than to entrust regulatory authority over satellite programming with local governments. The Commission must resist municipal entreaties to grant them with authority over any more than "the" basic tier defined in 623(b)(7).

C. Jurisdictional Division [¶14-16]

Many Comments would have the Commission assume direct regulatory responsibility for basic cable rates in all of the 30,000 franchise areas which do not "certify" their jurisdiction. Not only is this contrary to the Act, but it is administratively unnecessary. By adopting the basic benchmark rates proposed in our earlier Comments, and by limiting cost of service studies to a safety valve against confiscation, the Commission can minimize the administrative complexities which might discourage local certification, and provide local jurisdictions with ample opportunity to evaluate and regulate basic rates where they are so inclined.

D. Filing of Franchising Authority Certification [¶19-21]

NATOA glosses over the statute's plain demand that local franchising authorities certify their "legal authority" to apply the Commission's basic rate standards. NATOA believes that Congress can empower cities to regulate rates regardless of state and local restrictions. If Congress had done so, the statute would have made no reference to such a required showing of legal authority, and would have presumably been accompanied by a constitutional explanation for ignoring the accepted limits on intrusion into the allocation of power within a state[1/], as it

---

1/ See discussion at L. Tribe, American Constitutional Law § 5-22 (2d ed.).

did in other significant departures. E.g., H. Rep. 58-74. As creatures of state law, franchising authorities must find in state and local law their "legal authority" to certify. Likewise, if they are parties to agreements not to regulate, they may not constitutionally abrogate those agreements, nor may the Commission empower them to do so.

Austin goes so far in stripping meaning from the statute's certification qualifications that it argues a city should be certified "even if it does not believe that it is qualified to be certified." Congress would not have imposed standards of certification if every city in America qualified by virtue of its corporate status.

NATOA also contends that the absence of effective competition should have no bearing on certification, because effective competition does not appear as a certification standard in 623(a)(3). By the terms of 623(a)(2), the absence of effective competition is the jurisdictional predicate for any regulation under 623(a), (b) or (c). It would be a colossal waste to permit certification or its aftermath in competitive markets. Administrative efficiency is a statutory goal. It can best be achieved as CR&B suggested in Comments, by pre-filing notices and with threshold motions to avoid the apparatus of rate regulation in markets facing effective competition.

E. Joint Regulation

NATOA and Austin seek the right to engage in joint certification not only among franchising authorities served by a single system but among local authorities seeking to build an inter-jurisdictional tribunal over multiple operators. We have previously explained that unless a common franchise has been granted, and thus common obligations incurred, joint certification would force fit a system with divergent costs into a single homogenized mold. It would also enormously complicate the ability of a franchisee to work out informal settlements with franchising authorities. The cities' new request that the Commission endorse still wider expansion of a franchising authority's jurisdiction would take the Commission into territory entrusted to state legislatures. State legislatures can empower municipalities to enter into joint powers agreements, but often limit the scope of such pacts. Minnesota, for example, abolished its state cable commission. It is not for the Commission to "empower" cities to form new governmental entities which state legislatures have denied to them.

IV. BASIC RATE STRUCTURE

A. Standards [¶34-61]

1. CFA

The most astonishing aspect of CFA's Comments is its abandonment of the Act which it fought so hard to obtain. Half of its Comments argue that there should be an Act, and the remainder seek to reshape the Act that was, in fact, passed. During consideration of the 1992 Act, CFA launched a celebrated defense of the "effective competition" standard for basic rates. Its dubious estimate of a $6 Billion savings to consumers if basic rates were set at the level of competitive markets gained rapid currency. Now, amidst 161 pages of Comments, barely a page (84-85) is spent on comparing basic cable rates with rates in markets with effective competition, and the $6 Billion estimate is nowhere to be seen. Instead, CFA advances a "global formulaic" approach to advance "the ideal regulatory scheme [which] would deliver all cable channels at cost" (p.15). This oversimplification takes a standard Congress applied only to regulated equipment and extends it to cable service rates Congress never intended to be set "at cost." CFA ignores virtually every other standard, such as administrative efficiency, the comparison of rates to similarly situated systems, and the complex balancing of interests (such as the future of diverse and creative programming).

CFA's methodological innovation of "weighting" programs by quality merits special comment. It would entrust the government with the subjective evaluation of the contents of expression -- a role contrary to both the First Amendment and to the Communications Act. It would also eliminate from cable policy any opportunity for niche programming to flourish, and replace the promise of programming diversity with the mass appeal broadcast product which cable has transcended. CFA's proposal is rooted in an unwillingness to live with the Act which Congress did pass, and must be rejected by the Commission.

2. NATOA

NATOA is in basic agreement that benchmarks drawn from markets which have sustained effective competition should be the basis for basic service regulation. However, its procedural implementations would defeat the very purpose of those benchmarks. NATOA would insist, for example, that an operator could not "unilaterally" adjust its rates up to benchmark if basic rates were below them. No adjustment would be permitted even as part of a revenue neutral basic/tier price adjustment, or to pass through third party programming increases over which the operators had no control. Adjustments -- even within benchmarks -- would require a cost of service study. It would, unlike CFA, permit a high cost operator to exceed benchmarks after an appropriate showing that costs exceeded benchmarks; but it insists on the "reciprocal" right of franchising authorities to reduce rates which are within benchmarks by opening up a cost of service/rate of return rate case.

This conceptual construct would destroy the benchmarking system. By definition, benchmarks drawn from competitive markets fully protect consumers by extending to them the rates which would apply in competitive markets. Benchmarks do so without the need for cost of service studies or the tortuous development of an appropriate "rate of return" on the cable and programming business. Consumers suffer no harm if rates are within benchmarks, because they obtain all of the benefits available in competitive markets. The notion that consumers deserve better, if an operator's "cost" of service is still less, reflects a classical utility ratemaking mindset, coupled with a belief that returns should be razor thin, which will plunge regulators back into cost of service studies. With them would come the attendant disincentives for programming, innovation, creativity, and economies which benchmarks are designed to replace.

Creating a right to demand rates below benchmarks is not required for "symmetry." A high cost operator has a constitutional right to recover those costs, if he is willing to undertake the difficult path of a rate case. Creating a "symmetrical" right of the government to apply cost of service standards to operators within benchmarks assumes a nonexistent reciprocal "right," would seek to provide consumers with a rate which would not arise in a competitive market, and would make benchmarks a meaningless point in a world driven by complex cost of service regulation.

3. NAB

NAB's contribution to the rulemaking is to recommend that cable be given a modest return on the replacement value of assets and act only as the transparent billing conduit for programming and operating costs, without return. Many operators pay considerably more than book -- and even more than replacement value -- in order to capture unrealized economies and the going concern value of assets fully organized and ready for business. NAB's proposal would simultaneously strip operators retroactively of that investment; remove them from any role in assembling programming -- the value broadcasters repeatedly ascribe to assembling a broadcast day; and remove from cable the rewards (and incentives) for innovation and creativity. Its obvious goal is to assure broadcasters an untrammeled right to flow through retransmission consent fees to cable subscribers, while simultaneously hobbling cable. Given NAB's long history of efforts to restrain the growth and development of cable, this latest cynical foray should come as no surprise. If NAB is right in its economic approach, we assume that the Commission will also limit broadcast station sales prices to the replacement cost of the transmitter, less the value of the public spectrum. Of course, the cost of broadcast programming would flow through without markup to subsequent purchasers of advertising time.

4. Austin

Austin professes a greater allegiance to measuring current basic prices against prices in markets with effective competition, but it has so gamed the selection of benchmark markets as to produce a result at war with reality. We noted above how it has sought to exclude from the definition of "effective competition" most markets which are subject to it. In its appendices, Austin abandons any pretense of honest reporting and simply eliminates from its computation of competitive benchmarks those overbuilds with rates higher than Austin would like. Austin's lame explanation -- that Orange County, for example, is under purchase agreement -- ignores the fact that the overbuild rates increased dramatically well before the purchase agreement.[2/] Excluding competitive markets merely because the rates are high is unfaithful to the term and purpose of the Act. The Act does not say that basic rates should be measured against "markets subject to effective competition and really low rates."

2/ Kagan reported that Orange County rates increased from $7.95/$8.95/$11.95 for the three operators to $18.95/$17.95/$20.70 by early 1992, well before the Central Florida overbuild sold out. Cable TV Franchising, June 28, 1991; April 30, 1992. Wall Street Journal, Dec. 10, 1992.

5. Cost Allocation

Many of the details of the NATOA and Austin proposal for basic rate standards reflect a similar effort to dodge the terms of the Act and to escape the financial consequences of local demands placed on cable through the franchising process. For example, NATOA's effort to trivialize the costs of public, educational, and governmental access support is really an effort to place those costs anywhere but in my back yard. PEG costs are not minor. They can amount to 5% of an operator's gross revenues, and even more in grandfathered franchises. But NATOA would have that access support stripped of any compensation for overhead -- when many franchises require that system offices be sufficient in size, staffing, support and overhead to also sustain colocated access studios. Those costs have to be recovered somewhere, and the NIMBY approach is just one more effort to hide the costs from basic subscribers and force cable operators to recover them, if at all, in upper tiers or premium services.

Likewise, NATOA seeks to bury the real cost of local fees and taxes by insisting that operators receive local approval from the franchising authority before passing along the very cost increases imposed by that franchising authority. CR&B has previously explained that increases in franchise fees, taxes, and PEG support should be flowed through without consent. There is no basis for the government which imposes those costs to object to the pass through of costs which are entirely within its control.

The same disingenuous effort to shift costs away from basic appears in NATOA's suggestion that retransmission consent cost should not be passed through to basic customers, on the theory that customers already place a "value" on such signals and therefore should be assumed to have paid for them. Perceived value does not define cost, particularly because customers are not yet paying for retransmission consent. When those costs <u>are</u> incurred, they should flow through to customers.

6. "<u>Normative Costs</u>"

NATOA, Austin, NAB and CFA all seek to limit some or all of cable's recovery to "normative" costs. The industry has made large increases in capital expenditures since 1984, most of them in disproportionately large "lumps." The cost structure of the industry has not stabilized sufficiently to calculate a national average cost, nor is it soon likely to do so in an era of rapid technological innovation. The Comments which advocate "normative costs" are notably silent on specifics, leaving the heavy empirical lifting to the Commission. They have also couched their request for "normative" rates with demands that systems with below average costs reduce rates still further. This structure of rate regulation is not only administratively overwhelming, but a formula for confiscation.

7. Consumer Protection

One last example of NATOA's disregard for the statute is its suggestion that consumer protection jurisdiction provides a blank check for franchising authorities to override the limitations on rate regulation set forth in Section 623. The authoritative history accompanying the 1984 Act provides: "A state or franchising authority may not, for instance, regulate the rates for cable service in violation of Section 623 of Title VI, and attempt to justify such regulation as a 'consumer protection' measure." H. Rep. 98-934 at 79. The 1992 Act rewrote both the rate regulation and consumer protection sections of the legislation. Section 623 of the 1992 Act sets forth, in explicit detail, how franchising authorities may regulate rates for cable service and equipment. Since Congress has enacted a broad regulatory scheme regarding rate regulation, it is neither necessary or appropriate to apply more general consumer protection-based common law principles to this area.[3/]

B. Equipment Pricing [¶63-71]

The calculation of regulated equipment costs must include recovery of overheads and the cost of capital. NATOA suggests that "cost" is the invoice price of the equipment, FOB

3/ See, e.g., Isbrandtsen Co. v. Johnson, 343 U.S. 779 (1982); Texas & P.R. Co. v. Abilene Cotton Oil Co., 204 U.S. 426 (1907).

the warehouse, as though there are no other costs incurred in storing, deploying, repairing, maintaining, replacing, or financing equipment. NATOA goes still further to suggest that while service prices should be regulated on the basis of elaborate cost of service studies, operators who have "traditionally" provided equipment with a particular level of service should continue to do so, for free. Things don't come free even if NATOA wishes it so. The statute suggests unbundling and requires compensation.

NATOA reaches again in its proposal for jurisdiction over the pricing of all equipment used by basic customers. Considering that NATOA recommends that basic be a mandatory buy through for all service, that would leave the FCC with digital music receivers and local governments with all else. CR&B's proposal to link equipment with the service for which it is deployed makes for greater sense.

C. Implementation & Enforcement [¶79-89]

1. Delays

NATOA's procedural proposals for processing basic rate adjustments seem designed to artificially postpone all increases, however legitimate. Under its proposal, even an adjustment within benchmarks could take 240 days at the local level: